



## GOVERNOR'S TRANSACTION PRIVILEGE TAX SIMPLIFICATION TASK FORCE MINUTES

Tuesday, September 25, 2012

1:30 PM

1700 W. Washington, Governor's 2<sup>nd</sup> Floor Conference Room  
Phoenix, Arizona 85007

A public meeting of the Transaction Privilege Tax Simplification Task Force was convened on September 25, 2012 in the 2<sup>nd</sup> Floor Conference Room, 1700 West Washington, Phoenix, Arizona 85007. Notice having been duly given. Present and absent were the following members of the Task Force.

### Members Present

Michael Hunter (Chair)	Linda Stanfield
John Olsen	Keely Hitt
Miguel Teposte	Lynne Herndon
Tom Belshe	Vince Perez
Kevin McCarthy	Senator John McComish
Steve Barela	Representative Rick Gray

### Members Absent

No members were absent.

### Others Present

Lorna Romero, Governor's Office	Patrick Irvine, Fennemore Craig
Lindsay Scornavacco, Governor's Office	Craig McPike, Snell & Wilmer
Jennifer Solis, Department of Revenue	

### 1. Call to Order

Michael Hunter called the meeting to order at 1:40 p.m.

### 2. Approve Previous Meeting Minutes

Keely Hitt made a motion to approve the minutes from the past four TPT Task Force meetings.

Lynne Herndon seconded the motion.

The Task Force unanimously approved the minutes.

### 3. Update on Online Retail Working Group

Mr. Hunter stated Dennis Hoffman, Chair of the Online Retail Working Group, is out of town and would be unable to give a presentation on his working group. Instead, Dr. Hoffman's next working group meeting will be an in depth discussion of a couple of big issues the group is facing, online travel companies, sourcing and federal legislation that will impact online retail and remote sales. Mr. Hunter handed out a document to the Task Force from the Department of Revenue containing draft

legislative language. He emphasized this language is a draft and encouraged members of the Task Force and the public to give their input at the next working group meeting.

**a) Task Force Discussion**

No comments were made.

**4. Report from State and Local Standardization Working Group**

Patrick Irvine, Chair of the State and Local Standardization Working Group, gave a presentation on the progress of his working group. He stated the main question for the working group to answer is what makes the Arizona sales tax system one of the most complicated in the country. Some of the reasons the working group identified included multiple licensing contracts, multiple returns, multiple audits and multiple state and local tax bases. Mr. Irvine stated the goals of the working group should be to have a single licensing contact, single return, single audit and a single tax base or minimal local choice variations. He also discussed the history of the current system and factors that lead to the existence of non-program cities. Future working group meetings will continue to focus on the most troublesome differences between state law and the Model City State Code and will begin to formulate recommendations for the Task Force.

**a) Task Force Discussion**

Mr. Hunter asked everyone to think of the tax system they would design if there were not obstacles with the Department of Revenue, legislature or the history of the state. In a previous meeting, Keely Hitt explained when Circle K files taxes in Florida it amounts to one sheet of paper and when they file in Arizona it is an entire ream. Mr. Hunter recognized that members of the Task Force may wonder if that is a reasonable goal with the state's history but also recognized the hard work Mr. Irvine has done to help move the state in that direction. He explained the goal of the Task Force is to produce recommendations to lawmakers and the executive branch to develop policy.

Tom Belshe stated sometimes the perception is that the League does not think there is a solution and that is incorrect. He thanked Mr. Irvine, stating he articulated the concerns of the cities very well. He continued the League is trying to understand what the costs will be in order to make budgetary decisions. The League would like to have as little fiscal impact on cities as possible, but knows there is no way to have zero effect. Mr. Belshe stated the League agrees with the goals of the working group but is just cautious about how the group gets there. He needs that information before the League can offer their support. Mr. Belshe continued he believes the League is making a lot of progress in a short amount of time specifically with the online retail base and construction contracting. He does not think solutions to all of the problems will be decided by December, but believes the goals are laudable and that the group should work toward them.

Mr. Hunter stated that with the national effort moving toward simplification the question arises if Arizona will miss out on the movement because of the flawed system. He asked Mr. Belshe if the progress occurring in identifying discrepancies is enough to get Arizona in line.

Representative Gray stated the online portal created by his legislation should be enough to meet the one base required by the streamline movement. The state is allowed to have one base with variable rates. He stated when Ms. Hitt is submitting taxes for Circle K it would be one click of the mouse instead of a ream of paper. The portal takes the process from hours and days to minutes and seconds. It will not be a cost factor to the cities, but a savings. The cities will have a cost burden lifted which

translates to increased revenue. Representative Gray stated the group needs to look at a cloud based secured computer system for the portal. He continued the group will have to answer some philosophical questions and decide whether it is up to the state to ensure each city is held harmless or if cities should compete like states do. He does not think the actual collection and simplification will be an issue.

Mr. Belshe stated he agrees with Representative Gray. The League views the online portal as sufficient to meet the single point of contact requirement. He continued he is concerned with the idea of a single base. There will be winners and losers.

Vince Perez stated that once the League and the Department of Revenue can work out the last five issues then the Department of Revenue can begin to quantify the implications in terms of dollars.

Kevin McCarthy stated for decades there have been two sides to this debate: the local control camp keeping the interests of the cities and taxpayers complaining about compliance issues. In his opinion, 2012 is the first time both groups should have a common interest to take care of the problem. Arizona is losing a significant amount of revenue, which eclipses other arguments. He stated the rest of the country has updated its system while Arizona stays in the land of 1950. Changes will not happen overnight, but there should be long term goals.

Mr. Perez stated he is meeting with legal staff at the Department of Revenue to do an analysis of the major pieces of federal legislation. He hopes to provide the Task Force a bulleted list of requirements for each bill.

Mr. Hunter stated he was introduced to the streamline movement a decade ago and since then it has lost some support. Maps of the country show some states are participating in a marginal way or not at all. Arizona finds itself competing with states like California and Texas who are inclined not to participate. Some believe the federal legislation will require states to streamline. Arizona really has to simplify its tax code. He asked the Task Force which side of the argument they felt was correct, either that all states will have to be streamlined or that Arizona does not have to worry since big players may not comply.

Mr. Belshe responded he thinks the state needs to move toward a system like streamline as quickly as possible. He mentioned the streamline base is much broader than Arizona's and that it would be helpful to have a group discussion on that topic.

Ms. Hitt commented that for a multi-state taxpayer it is very helpful to have the same definitions apply to all states.

Mr. Irvine stated a former student of his now works in Washington D.C. This student is conducting a lot of research on behalf of the tribes regarding the streamline movement. He continued Indian tribes have not been on the forefront of tax policy and his student's organization doing research is indicative of the view in Washington that the wave is coming.

Mr. Hunter stated another topic the working group explored is the multijurisdictional audit and its usefulness. The idea behind this was to make it easier for taxpayers when auditors came through their shop. Most taxpayers opt not to participate when they are tied to two different districts because

it can get very complicated. They take the chance that even if they get a state audit they will not get audited in their city. He continued the auditors at the Department of Revenue use limited resources the best way possible. This may or may not correspond with local issues. Mr. Hunter asked how program city models are working better than non-program city models.

Mr. Irvine stated there is no easy answer. When taxpayers only want one audit, it requires a lot of trust between jurisdictions. This requires some sort of centralization.

John Olsen commented Gilbert, a program city, gets a lot of services from the Department of Revenue at no cost to the Department. It is Gilbert's perspective that having someone at the Department focus on this issue allows the town to focus on its customers. Gilbert is able to assist its taxpayers while it is difficult for the Department of Revenue to have that same focus with all of its audits and issues. Mr. Olsen stated he believes all local jurisdictions could help taxpayers more.

Mr. Perez stated between the cities and the Department of Revenue there are differences in the tax base and differences in focus, largely because cities have more interactions.

Mr. McCarthy commented multijurisdictional audits are one of the things that make Arizona the most complicated. He added a fifth problem to Mr. Irvine's list, which is auditors having multiple interpretations. Information needs to be found on how they are trained and where they are trained and there need to be sufficient resources for them to do their jobs properly. Consistent interpretations are a huge benefit to taxpayers trying to figure out the system.

Mr. Hunter stated when seeking help with multiple audits, the taxpayer is charged for each audit. It gets taken care of in one process, but does not alleviate the complexities of the audit. He proposed the reason for the complexity could be multiple interpretations.

Miguel Teposte asked for clarification on managed audits and joint audits.

Steve Barela gave an example of a transmission line spanning two cities with two different interpretations on how it is taxed. He will be meeting with the Department of Revenue to probably get a third interpretation.

The Task Force took a break at 2:50 p.m.

## **5. Report from Contracting Working Group**

The Task Force reconvened at 3:06 p.m.

Craig McPike, Chair of the Contracting Working Group, gave a presentation on the progress of his working group. He stated the current issues for the Task Force to consider are moving to a materials-based tax and deciding whether it would be a vendor-based or a contractor-based system, presenting the pros and cons of each method. There is still the open question of the financial impact of the various approaches and Mr. McPike mentioned the Department of Revenue is in the process of developing different models to get an idea of what the impact could be.

Representative Gray asked with regard to the contractor-based system if the contractor would be exempt when they purchase materials and be able to only tax the materials when they resell it to

customers.

Mr. McPike answered yes. It would simplify the issue of accepting prime contractor certificates for retailers. If the contractor marks up the price during resale, that markup is subject to tax.

Representative Gray stated he thinks that is a good solution. He continued currently a lot of overhead and other costs are being taxed and it is unfair. It is a different story when only the cost of materials is taxed.

Mr. Perez stated there needs to be more discussion on how it would work. In the simplest form, if a contractor buys materials for \$100 and sells them for \$100, then the tax is on \$100. If a contractor buys materials for \$100 and sells them for \$150, then the tax is on \$150. He continued the complexity comes into play when the contractor has to know which jurisdiction he is in and know the rates, not just for the city, but also for the county.

Linda Stanfield stated in the service industry many people buy their parts and materials ahead of time and do not know the prices. Right now everything is included into one price. Businesses now have to consider if the company is including the costs of materials or separating it out. Either way the service industry still has hoops to jump through.

Mr. McPike offered the idea of having a dollar threshold. If, for example, a threshold was set at \$1,000 then any minor purchases would simply be charged tax at the retailer and some burdens would be alleviated. He continued it would not work for every case, but it is an option.

Mr. Teposte asked what the impact would be on a contractor that purchases materials out of state.

Mr. McPike stated it would be treated the same as it is currently treated on the retailers side. The contractor would take a credit for the tax paid in another jurisdiction.

Mr. Teposte clarified that contractors would act as retailers and it would be sale for resale.

Senator McComish commented there does not seem to be an elegant solution. He asked if another state has a model Arizona can learn from, even if it meant scrapping TPT altogether.

Mr. McPike responded it was a fair question and stated several other states tax on materials with either the vendor-based or contractor-based system.

Mr. Hunter stated when moving to a tax on materials the group needs to answer how the state will deal with the distribution changes that occur. He continued he likes the senator's question and suggested looking at how other states deal with distributions.

Representative Gray commented the discussion goes back to how responsible the state is for revenue sharing. The Task Force's priority is to simplify the system. He asked if it was the priority to make sure each city gets its fair share or to allow cities to compete. He continued that as a business person he likes competition because he thinks it is better for the consumer. The group has to decide what its responsibility is.

Mr. Belshe stated he agrees with Representative Gray to a certain extent. He continued his parents own a business in Eagar and that there is no chance the town will ever get a Home Depot or an ACE Hardware built there. There is no way to capture the benefit of one of these businesses when changes to revenue are made and they are disincentivized to have construction. The League worries about remote communities and their ability to capture benefits. All cities are not operating from the same competitive advantage.

Representative Gray gave the example of a \$100,000 house that was remodeled and is now worth \$150,000. There is a property value increase. This would be the same benefit to those small communities. As a working group, the question of where revenue sharing falls on the list of priorities needs to be answered.

Mr. Belshe stated Representative Gray was absolutely right and that it is a hard question.

Mr. McCarthy agreed with Representative Gray's comments. He stated a lot of cities have seen benefits from population growth within their boundaries. Prime contracting is a unique feature that is not seen anywhere else. He continued prime contracting revenues have been very important to Gilbert for the past 30 years. The Task Force needs to have its eye on what the 30,000 foot goal is. He commended Mr. McPike for his suggestions.

Mr. Hunter commented many people probably wish the state had not gone down the path of TPT, but that it is the hand the state has been dealt. It is not in the state's interest to make the system more complex while attempting simplification. There needs to be a balancing act. The group needs to ask if the solutions reach the ultimate goal of a simpler system while not adversely hurting taxpayers or jurisdictions that rely on this revenue.

## **6. Call to the Public**

Tom Cantlon, a private citizen, commented that the transaction privilege tax is a regressive tax and asked the Task Force to keep in mind the impact their actions will have on middle to low wage earners.

## **7. Adjournment**

Mr. Hunter adjourned the meeting at 3:54 p.m.